



COUNTY OF LOS ANGELES TREASURER AND TAX COLLECTOR

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March 24, 2011

TO: William T Fujioka
Chief Executive Officer

FROM: Mark J. Saladino
Treasurer and Tax Collector 

SUBJECT: **LACERA'S RATE OF RETURN ASSUMPTION**

An editorial entitled "CalPERS's Irresponsible Return Rate" appeared in yesterday's edition of the *Press-Telegram*, and the same editorial appeared in today's edition of the *Daily News*. Copies of the editorials are attached for your reference.

The editorials criticized the governing board of CalPERS for adopting an assumed rate of return of 7.75%, rather than reducing the assumed rate of return to 7.5%, as recommended by the system's actuary.

CalPERS's action to maintain a 7.75% assumed rate of return mirrors an action taken by LACERA's Board of Investments late last year. In addition, last December, CalSTRS also reduced its assumed rate of return from 8% to 7.75%.

For the fiscal year ended June 30, 2010, LACERA's actual rate of return was 11.8% (gross of fees). For the first seven months of the current fiscal year, ended January 31, 2011, LACERA's actual rate of return was 16.3% (estimated, gross of fees).

The foregoing returns are not only far in excess of the 7.75% assumed rate of return, they also exceeded LACERA's "Policy Benchmark" returns by 2.3% and 0.9%, respectively. The "Policy Benchmark" return is essentially the weighted average return on a passive or "index" portfolio of investments, allocated among various asset classes in accordance with LACERA's investment allocation policy. The difference between LACERA's actual returns and the "Policy Benchmark" returns represent the value added by LACERA's investment managers through their active management.

LACERA's recent investment returns by asset class are detailed on Attachment 1 entitled "LACERA's Estimated Total Fund" (as of January 31, 2011).

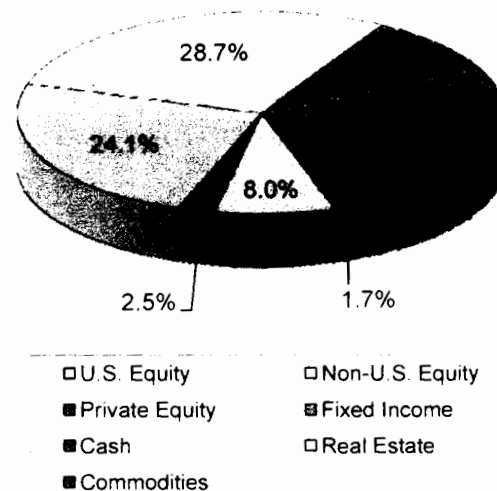
c: Board of Supervisors



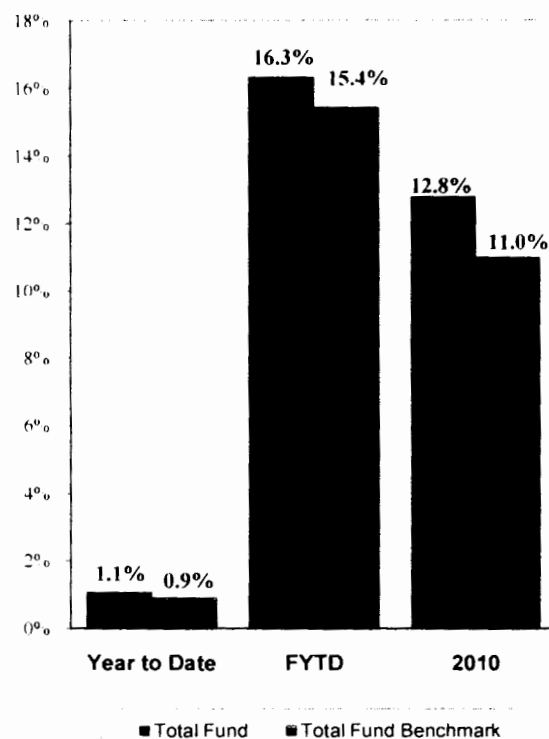
LACERA'S ESTIMATED TOTAL FUND

(as of January 31, 2011)

Asset Class		MARKET VALUE (millions)	ACTUAL % of Total Fund	TARGET % of Total Fund
EQUITIES				
U.S.	□	\$9,139.6	24.1%	22.0%
Non-U.S. (Hedged)	□	\$10,907.1	28.7%	30.0%
Total Public Equity		\$20,046.7	52.8%	52.0%
PRIVATE EQUITY	■	\$3,656.9	9.6%	7.0%
FIXED INCOME	■	\$9,663.4	25.4%	26.0%
REAL ESTATE	□	\$3,040.1	8.0%	10.0%
COMMODITIES	■	\$946.3	2.5%	3.0%
CASH	■	\$647.6	1.7%	2.0%
TOTAL FUND		\$38,000.9	100.0%	100.0%



Asset Class	Year-to-Date	Fiscal-Year-to-Date	2010
U.S. Equity	2.3	28.2	18.2
Russell 3000 Index	2.2	27.2	16.9
Non-U.S. Equity (Hedged)	0.7	24.6	11.4
Non-U.S. Equity Custom Hedged Idx. ¹	0.6	24.5	10.9
Private Equity ²	0.6	8.1	19.8
Private Equity Target Return ^{2,3}	0.5	3.8	5.1
Fixed Income	0.7	4.4	9.7
Fixed Income Custom Index ⁴	0.2	2.1	7.2
Real Estate ²	0.6	5.1	2.0
NPI minus 25 bps	1.3	8.5	5.6
Commodities	1.6	33.0	20.5
Dow Jones-UBS Commodity Index	1.0	30.5	16.8
Cash	0.2	1.2	2.6
Citigroup 6-Month T-Bill Index	0.0	0.1	0.2
TOTAL FUND	1.1	16.3	12.8



¹ Inception-8/31/08: MSCI ACWI X U.S. Net; 8/31/08-7/31/10: MSCI ACWI X U.S. IMI Net; 7/31/10-Present: MSCI ACWI X U.S. IMI Net Custom Hedged Index

² Performance calculations use the most recently available quarterly return to extrapolate a monthly return number.

³ Rolling ten-year return of the Russell 3000 plus 500 basis points (one quarter lag).

⁴ A combination of the Barclays U.S. Aggregate Bond Index and the Barclays U.S. High Yield Ba/B Index through 3/31/09. Barclays U.S. Universal beginning 3/31/09.

CalPERS's irresponsible return rate

The worker-dominated board of the nation's largest public pension program demonstrated last week that it is willing to put our children and grandchildren at financial risk to protect its own current interests.

Ignoring the recommendation of its own actuary, and turning a deaf ear to a growing chorus of financial experts, the directors of the California Public Employees' Retirement System clung to their optimistic and risky assumption that it will earn an average 7.75 percent annually on its investments during the next 19 years.

It's a stunning decision with profound implications. In the short run, the higher the assumed rate, the less money government employers, including the state, will be required to pay into the system now to cover future benefits. That means they will put less pressure on workers to contribute more to their pensions or to accept lower compensation elsewhere.

But if the investments don't live up to expectations, taxpayers in the future will be on the hook to make up the difference. Thus it's in workers' interests to keep the assumed rate high, for it keeps their costs down and lets future taxpayers bear more risk.

While we can't predict investment returns with any certainty, many are questioning how CalPERS can expect to earn such large returns. Some are saying that 5 percent to 6 percent is

more realistic. Some say even that's too high.

The system's own actuary suggested only lowering the rate to 7.5 percent. But even that was too much for the system board, whose members are current and retired employees; appointees of the governor; and key elected statewide officials.

The vote was 7-3. Only two holdovers from the Schwarzenegger administration and state Treasurer Bill Lockyer's representative supported the change.

We recognize state and local governments are strapped for cash. But tweaking the numbers to make them look better than they actually are ensures greater debt in the future. Even by its own questionable numbers, CalPERS today has only 70 percent of the funds it should have and is about \$100 billion short.

As the nonpartisan Little Hoover Commission, a state watchdog agency, reported last month, "Retirement plans typically use more optimistic assumptions to estimate contribution rates, which can undervalue and push costs onto future generations of taxpayers."

The commission recommends restructuring public-employee pension boards to provide greater representation of taxpayer interests. For CalPERS, that would take a ballot initiative. The time has come. The fiscal irresponsibility can no longer be tolerated.

EDITORIAL

Risky assumption

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